

HAIC POINT UTILITIES, INC.

**BEFORE THE SOUTH CAROLINA PUBLIC
SERVICE COMMISSION**

Testimony Prepared: July 8, 2005

Hearing Date: July 18, 2005

**APPLICANT'S REBUTTAL
TESTIMONY AND EXHIBITS**

THIS TESTIMONY IS FILED PURSUANT TO PSC ORDER DATED APRIL 11, 2005. THE APPLICANT RESERVES THE RIGHT TO PROVIDE REBUTTAL TESTIMONY TO THE TESTIMONY TO BE PRE-FILED, PURSUANT TO SAID ORDER AND TO THE PUBLIC SERVICE COMMISSION'S RULES OF PRACTICE AND PROCEDURE, BY THE COMMISSION STAFF AND INTERVENORS.

HAIG POINT UTILITY, INC.
DOCKET NO. 2005-34-W/S
BEFORE THE SOUTH CAROLINA PUBLIC
SERVICE COMMISSION
Testimony Prepared: July 8, 2005
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TESTIMONY-
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TAB A

**PRE-FILED REBUTTAL
TESTIMONY**

THOMAS F. CONNOR

HAIG POINT UTILITY, INC.

DOCKET NO. 2005-34-W/S

**PRE-FILED REBUTTAL TESTIMONY OF THOMAS F. CONNOR
BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

Testimony Prepared: July 7, 2005

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THIS TESTIMONY IS FILED PURSUANT TO PSC ORDER DATED
APRIL 11, 2005. THE APPLICANT RESERVES THE RIGHT TO
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SERVICE COMMISSION'S RULES OF PRACTICE AND PROCEDURE,
BY THE COMMISSION STAFF AND INTERVENORS.

1 **BY MR. WALKER: Please state your name for the record.**

2
3 BY MR. CONNOR: Thomas F. Connor.

4
5 **BY MR. WALKER: To refresh everyone's memory, what is your occupation?**

6
7 BY MR. CONNOR: I am the Controller of International Paper Realty Corporation and
8 serve as the Treasurer of Haig Point Utility Company, Inc. ("HPU" or "HPUC").

9
10 **BY MR. WALKER: Have you reviewed the prefled direct testimony of Douglas**
11 **Carlisle of the Office of Regulatory Staff?**

12
13 BY MR. CONNOR: Yes.

14
15 **BY MR. WALKER: Mr. Carlisle described the relationship of Haig Point Utility**
16 **Company, Inc., Haig Point, Inc. and International Paper. Do you recall his**
17 **testimony?**

18
19 BY MR. CONNOR: Yes. I believe Mr. Carlisle testified that Haig Point Utility
20 Company, Inc. is wholly owned by Haig Point, Inc. and that Haig Point, Inc. is wholly
21 owned by International Paper.

22
23 **BY MR. WALKER: Is this explanation correct?**

24
25 BY MR. CONNOR: Partially.

26
27 **BY MR. WALKER: Can you clarify the relationships?**

28
29 BY MR. CONNOR: Yes. Haig Point Utility Company, Inc. is a wholly owned
30 subsidiary of Haig Point, Inc. (formerly known as International Paper Realty Corporation
31 of South Carolina). Haig Point, Inc. is a wholly owned subsidiary of International Paper
32 Realty Corporation. International Paper Realty Corporation is a wholly owned subsidiary
33 of The Branigar Organization, Inc. The Branigar Organization, Inc. is owned by
34 International Paper Company and one or more of International Paper Company's affiliates
35 and subsidiaries.

36
37 **BY MR. WALKER: Have you reviewed the prefled direct testimony of Dawn Hipp**
38 **of the Office of Regulatory Staff?**

39
40 BY MR. CONNOR: Yes.

41
42 **BY MR. WALKER: Were you aware of the findings of the Office of Regulatory**
43 **Services Business Office Review Ms. Hipp discussed in her testimony?**
44

1 BY MR. CONNOR: Yes. I received a copy of the review report and discussed the
2 findings and corrective action plan on a conference call with Ms. Hipp and others on June
3 29, 2005.

4
5 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
6 **(ORS Business Office Compliance Review) that all records and reports required by**
7 **the Public Service Commission are not located in South Carolina, but, instead, are**
8 **kept in the HPU business office in Montvale, New Jersey. Can you comment on**
9 **this?**

10
11 BY MR. CONNOR: Yes. Ms. Hipp clarified this issue in the June 29, 2005 telephone
12 conference. The audit staff had requested to see certain copies of records and reports
13 during their site visit. Several of the records or reports were not readily available onsite
14 or the most-current version of the record or report was not readily available onsite. At
15 least one reason for this is space constraint on site. Ms. Hipp gave us valuable
16 suggestions on the types of records and reports which are required to be kept within the
17 state. HPU's management and staff are working together to ensure that all such
18 documents or copies thereof are either delivered to the Daufuskie Island site or that HPU
19 requests and receives an exemption from the Commission allowing it to maintain certain
20 records and reports off-site. HPU wishes to be in complete compliance with all
21 Commission rules and regulations.

22
23 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1 (ORS**
24 **Business Office Compliance Review) that HPU did not maintain a record**
25 **demonstrating service complaints made by utility customers. Can you comment on**
26 **this?**

27
28 BY MR. CONNOR: Yes. Pursuant to applicable regulations, all billing complaints made
29 by utility customers are entered into a complaint log which details the complaint
30 received, the complainant's name, the complainant's address, the date of the complaint,
31 the nature or character of the complaint, and the resolution or disposal of the complaint.
32 Although few service complaints are received, such complaints were not being recorded
33 in a formalized complaint log as the billing complaints were. HPU has since adopted the
34 same format utilized for the billing complaint log for service complaints. This has been
35 implemented already.

36
37 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1 (ORS**
38 **Business Office Compliance Review) that HPU did not maintain detailed**
39 **information to afford analysis of the utility's procedures, actions and resolutions to**
40 **specific customer service complaints. Can you comment on this?**

41
42 BY MR. CONNOR: Yes. In addition to implementing a service complaint log as I just
43 discussed, the utility is in the process of drafting a "protocol" for handling all complaints,
44 which will set forth the utility's complaint procedures. Although I understand that this
45 written protocol is not a technical requirement of the regulation, I thought it best to

1 develop it so that ORS would feel comfortable with the procedure for handling
2 complaints.

3
4 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
5 **(ORS Business Office Compliance Review) that HPU did not maintain rates,**
6 **rules/regulations, maps and plans available for public inspection within the service**
7 **territory. Can you comment on this?**

8
9 BY MR. CONNOR: This is in the process of being remedied. All such documents will
10 be made available for public inspection at HPU's Daufuskie Island site.

11
12 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
13 **(ORS Business Office Compliance Review) that HPU had no procedure to assure**
14 **that utility customers registering complaints are made aware that HPU falls with**
15 **the Commission's jurisdiction and, therefore, that the customer is free to lodge a**
16 **complaint with the Commission. Can you comment on this?**

17
18 BY MR. CONNOR: We discussed the required method for notifying customers of this
19 fact with Ms. Hipp in our June 29, 2005 conference call. It is our understanding that
20 printing a statement on the customer utility bill is sufficient to provide notice to potential
21 complainants of their right to complain to the Commission about any issue. Ms. Hipp
22 generously offered to provide the utility with sample language to add to the bill. Once
23 we receive this language we will add the recommended statement to HPU's customer
24 utility bills.

25
26 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
27 **(ORS Business Office Compliance Review) that HPU does not file notices of DHEC**
28 **rule violations with the Commission. Can you comment on this?**

29
30 BY MR. CONNOR: Yes. To my knowledge, HPU has received only one Notice of
31 *Alleged* Violation from DHEC since its inception. This Notice of Alleged Violation was
32 issued on April 26, 2005 and involved the permitting of a new, redundant groundwater

33
34
35
36 responses to their First Continuing Data Request. These responses were presented to the
37 Office of Regulatory Staff on May 27, 2005. HPU understands that the two regulations
38 cited with regard to this issue, South Carolina Regulations 103-514 and 103-714, require
39 only that HPU file written notice to the Commission of any "violation of DHEC rules"
40 which "affect[s] the service provided to its customers." First, DHEC had only *alleged* a
41 violation of state permitting regulations when it issued the Notice of Alleged Violation.
42 HPU disagreed with these allegations. Thus, there was no agreement that a violation had
43 actually occurred. Second, because the permitting issue was a technical procedural
44 matter regarding a redundant well, HPU did not believe that it was a violation which
45 potentially "affected the service provided to its customers." Thus, for these two reasons,
46 HPU did not feel that a report to the Commission was necessary and, thus, did not report

1 the April 26, 2005 Notice of Alleged Violation. In our conference call with Ms. Hipp on
2 June 29, 2005, she clarified that it is the Commission's position that all Notices of
3 Alleged Violation, regardless of their nature, should be reported to the Commission. She
4 also stated that it is the Commission's position that any potential violation of any type
5 within the utility could potentially affect the utility's service to its customers. With this
6 knowledge, in the future, HPU will report all DHEC Notices of Alleged Violation to the
7 Commission. With regard to the April 26, 2005 Notice of Alleged Violation, IIPU and
8 DHEC are trying to negotiate a Consent Order, which, upon execution will be reported to
9 the Commission.

10
11 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
12 **(ORS Business Office Compliance Review) that HPU's bond amount is insufficient.**

16 Continuing Data Requests, it supplied two performance bonds, each in the amount of
17 Twenty Thousand Dollars (\$20,000.00), one for the water system and one for the sewer
18 system. These were issued by the Travelers Casualty and Surety Company of America.
19 Copies of these bonds had been previously supplied to the Commission, specifically to
20 Mr. William O. Richardson. The bond amounts were decided upon after HPU discussed
21 the issue with a Commission representative, who informed HPU that the bond amounts
22 were sufficient. In our telephone conference with Ms. Hipp and in her prefiled direct
23 testimony, she indicated she would recommend to the Commission bonds in the amount
24 of Three Hundred Fifty Thousand Dollars (\$350,000.00) each for water and sewer. IIPU
25 is in the process of having bonds in these amounts issued or having riders issued to
26 increase the current bond amounts to the suggested amounts. HPU is willing to increase
27 these bonds to the suggested levels.

28
29 **BY MR. WALKER: Ms. Hipp noted in her testimony and in Exhibit DMH-1**
30 **(ORS Business Office Compliance Review) that there was a small leak observed on**
31 **Tank #1 during the audit staff's site inspection. Can you comment on this?**

32
33 BY MR. CONNOR: It is my understanding from onsite staff that the staff was aware of
34 this leak and it is in the process of being addressed. It was necessary to order a
35 replacement valve. When the onsite staff receives the replacement valve, the leak will be
36 repaired. Again, HPU wishes to be in complete compliance with all Commission rules
37 and regulations and to remedy any deficiencies found in the audit and site inspection.

38
39 **BY MR. WALKER: I am going to show you what I will mark as Applicant Exhibit**
40 **5. Can you identify this document?**

41
42 BY MR. CONNOR: This is the application submitted by HPU in support of its rate
43 application.

44
45 *[EXHIBIT 5]*

1 **BY MR. WALKER:** As part of your role with HPU, did you review this rate
2 application which we have marked Exhibit 5?
3
4 **BY MR. CONNOR:** Yes.
5
6 **BY MR. WALKER:** Did you specifically review the Schedules in Support of a Rate
7 Increase authored by Guastella Associates and included within the application
8 marked as Applicant's Exhibit 5?
9
10 **BY MR. CONNOR:** Yes.
11
12 **BY MR. WALKER:** How are availability fees treated within the Water Operating
13 Statement [Schedule C-1(W)] which is included within Applicant's Exhibit 5 and
14 also within Applicant's Exhibit 4?
15
16 **BY MR. CONNOR:** Availability fees are treated as revenue to the utility.
17
18 **BY MR. WALKER:** What is the purpose of the availability fee?

19 ~~21~~ ~~22~~ ~~23~~ ~~24~~ ~~25~~ ~~26~~ ~~27~~ ~~28~~ ~~29~~ ~~30~~ ~~31~~ ~~32~~ ~~33~~ ~~34~~ ~~35~~ ~~36~~ ~~37~~ ~~38~~ ~~39~~ ~~40~~ ~~41~~ ~~42~~ ~~43~~ ~~44~~ ~~45~~ ~~46~~
21 ~~22~~ ~~23~~ ~~24~~ ~~25~~ ~~26~~ ~~27~~ ~~28~~ ~~29~~ ~~30~~ ~~31~~ ~~32~~ ~~33~~ ~~34~~ ~~35~~ ~~36~~ ~~37~~ ~~38~~ ~~39~~ ~~40~~ ~~41~~ ~~42~~ ~~43~~ ~~44~~ ~~45~~ ~~46~~
22 they become a connected customer.
23
24 **BY MR. WALKER:** Is this fee charged to all owners of undeveloped lots?
25
26 **BY MR. CONNOR:** Yes. It is charged to all sold, yet undeveloped lots. It is not based
27 on any other criteria.
28
29 **BY MR. WALKER:** When the availability fee was designed, was the purpose the
30 same as you have just described?
31
32 **BY MR. CONNOR:** To my knowledge, yes.
33
34 **BY MR. WALKER:** How was the capital cost of building the initial water and
35 sewer infrastructure and any additions thereto financed?
36
37 **BY MR. CONNOR:** All construction has been funded by construction advances from
38 Haig Point, Inc.
39
40 **BY MR. WALKER:** How are availability fees charged to undeveloped lot owners?
41
42 **BY MR. CONNOR:** Pursuant to the HUD statement for the properties within Haig Point
43 Plantation, when a lot is sold, but remains undeveloped, the lot owner must pay an annual
44 availability fee of One Hundred Eight Dollars (\$180.00) to Haig Point, Inc., the
45 developer.
46

1 **BY MR. WALKER: I am going to hand you a document which I will mark**
2 **Applicant's Exhibit 6. Can you identify it?**

3
4 BY MR. CONNOR: This is the HUD statement which requires the lot owner to pay an
5 availability fee to the developer, Haig Point, Inc. This provision is contained on page 12
6 of the document.

7
8 *[EXHIBIT 6]*
9

10 **BY MR. WALKER: When the lot is developed, the annual availability fee ceases to**
11 **be charged?**

12
13 BY MR. CONNOR: Yes.

14
15 **BY MR. WALKER: Who collects the availability fees?**

16
17 BY MR. CONNOR: Haig Point, Inc. collects the availability fees.

18
19 **BY MR. WALKER: Where are the availability fees deposited?**

20
21 BY MR. CONNOR: To the account of Haig Point, Inc.

22
23 **BY MR. WALKER: Where are the availability fees booked?**

24
25 BY MR. CONNOR: On the books of Haig Point Utility, Inc.

26
27 **BY MR. WALKER: Why are the availability fees booked on the utility's books?**

28
29 BY MR. CONNOR: The availability fees are used to offset operating and carrying costs
30 for the utility. Therefore, the amounts collected for the availability fees are recorded as
31 revenues on the utility's books.

32
33 **BY MR. WALKER: Has the purpose of the availability fee ever been to provide**
34 **advances or financing from the developer to the utility for construction capital**
35 **costs?**

36
37 BY MR. CONNOR: No.

38
39 **BY MR. WALKER: Is Haig Point, Inc. obligated to utilize the funds generated by**
40 **availability fees to offset operating deficits of the utility?**

41
42 BY MR. CONNOR: No, but it intends on continuing to do so.

43
44 **BY MR. WALKER: Did you have the opportunity to review the prefiled testimony**
45 **of Ms. Sandra Scott of the Office of Regulatory Services?**

46
47 BY MR. CONNOR: Yes.

1 **BY MR. WALKER: Is there any portion of Ms. Scott's testimony which you wish**
2 **to address?**

3
4 BY MR. CONNOR: Yes. For the most part, Mr. White and Mr. Guastella will address
5 Ms. Scott's testimony. I did, however, wish to comment on Audit Exhibit SGS-4,
6 Adjustment No. 16 (Property Taxes). The Office of Regulatory Staff proposes to adjust
7 property taxes based on historical assessment patterns. The property tax calculation
8 utilized in the application was based on the state tax rate of 10.5% of the fair market
9 value of the real property, including structural improvements. The utility is attempting to
10 resolve the issue of whether or not Beaufort County will make an assessment on
11 structural improvements. We hope to have resolution to this issue before the hearing
12 before the Commission. However, we felt it prudent to include and adjust for the
13 payment of this tax and have done so in our application.

14
15 **BY MR. WALKER: Does this conclude your testimony/?**

16
17 BY MR. CONNOR: Yes.

TAB B

PRE-FILED REBUTTAL TESTIMONY

GARY C. WHITE

HAIG POINT UTILITY, INC.

DOCKET NO. 2005-34-W/S

PRE-FILED REBUTTAL TESTIMONY OF GARY WHITE

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Testimony Prepared: July 7, 2005

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1 **BY MR. WALKER: Please state your name.**

2

3 BY MR. WHITE: Gary C. White.

4

7 BY MR. WHITE: Yes.

8

9 **BY MR. WALKER: Please refresh our memory as to your occupation.**

10

11 BY MR. WHITE: I am the Director of Accounting with Guastella Associates, Inc.

12

13 **BY MR. WALKER: Have you reviewed the testimony of the Office of Regulatory**
14 **Staff?**

15

16 BY MR. WHITE: Yes, I have reviewed their direct testimony.

17

18 **BY MR. WALKER: What issues does your rebuttal testimony address?**

19

20 BY MR. WHITE: My rebuttal testimony addresses several areas as follows:

21

22 First, I will address Dr. Douglas Carlisle's calculations on Exhibit DHC-1.

23

24 Second, I will address several of the adjustments reflected in the testimony and exhibits
25 of Ms. Sharon Scott. Specifically, I will discuss the issues with Adjustment No. 3,
26 Adjustment No. 5 (Salary Expense), Adjustment No. 12 (Rate Case Expense),
27 Adjustment No. 14 (Depreciation Expense), Adjustment No. 20 (Accumulated
28 Depreciation), Adjustment No. 22 (Contributions in Aid of Construction), Adjustment
29 No. 23 (Amortization of CIAC), Adjustment No. 24 (Cash Working Capital) and
30 Adjustment No. 25 (Unamortized Balance).

31

32 **BY MR. WALKER: Mr. White during your examination and review of Dr. Douglas**
33 **Carlisle's direct testimony did you discover any portions of his testimony or exhibits**
34 **with which you disagree?**

35

36 BY MR. WHITE: Yes, in my opinion, Dr. Carlisle's method of calculating debt and
37 equity costs on his first exhibit, which he refers to as Exhibit DHC-1, are incorrect. To
38 calculate the cost of the capital component, one would multiply the weighted cost rate by
39 the total rate base capital or would multiply the embedded cost rate times the amount of
40 the individual capital component. Dr. Carlisle multiplied the weighted cost rate by the
41 amount of the individual capital component which understates both the cost of debt and
42 equity. His first table on Exhibit DHC-1 should reflect \$57,086.00 of debt cost and
43 \$73,451.00 of equity cost, not the \$28,543.00 and \$36,725.00 respectively, as shown by
44 his calculation.

45

46 His second table should reflect \$68,503.00 of debt cost and \$58,761.00 of equity cost.

1 The equity return difference between the 50/50 and 60/40 capital structures discussed on
2 page 4, line 11, of Dr. Carlisle's testimony should be \$14,690.00, not \$7,345.00 as stated.

3
4 The third table should show that the rate base needed for HPUC to earn an equity return
5 of \$141,612.00 with a cost rate of 9.65% would be \$2,934,964.00, not the rate base of
6 \$5,869,927.00 as shown.

7
8 The fourth table should show 9.30% as the weighted cost rate and 18.6% as the
9 embedded cost rate of equity. The conclusions developed and demonstrated on Dr.
10 Carlisle's first exhibit are all incorrect.

11
12 **BY MR. WALKER: Does this conclude your rebuttal of Dr. Carlisle's testimony**
13 **and exhibits?**

14
15 BY MR. WHITE: Yes. Mr. John Guastella will provide further rebuttal testimony on
16 capital costs, rates of return, and operating margins.

17
18 **BY MR. WALKER: During your examination of Ms. Sharon Scott's testimony and**
19 **exhibits did you discover any portions of his testimony or exhibits with which you**
20 **disagree?**

21
22 BY MR. WHITE: Yes. There are errors or questions regarding several of the Office of
23 Regulatory Services' adjustments as detailed by Ms. Scott in her testimony and exhibits.

24
25 **BY MR. WALKER: In which portions of the testimony of exhibits did you find**
26 **fault?**

30
31 **BY MR. WALKER: Please explain the error you found in Audit Exhibit SGS-4,**
32 **Adjustment No. 3 and No. 5 (Salary Expense).**

33
34 BY MR. WHITE: Adjustment No. 5 understates the amount wages should be increased
35 to reflect the projected six employees needed for the complete system test year. In
36 Adjustment No. 3, the Office of Regulatory Staff reduces the 2004 test year wage and
37 benefits expense by \$14,248.00, which would result in an adjusted test year expense of
38 \$63,476.00 (\$77,724.00 less \$14,248.00). In Adjustment No. 5, the Office of Regulatory
39 Staff is adjusting the wage and benefit expense to reflect the level necessary for six
40 employees or \$190,428.00 as stated on page 6, line 16 of Ms. Scott's testimony. To
41 establish the amount of the adjustment, the Office of Regulatory Staff subtracts
42 \$77,724.00 from the \$190,428.00 which results in an incorrect amount of \$112,704.00.
43 This amount, when added to the adjusted test year amount of \$63,476.00 established in
44 Adjustment No. 3, results in a total wage and benefit expense of \$176,180.00 or
45 \$14,248.00 less than the target amount of \$190,428.00. The Office of Regulatory Staff's
46 adjustment should be \$126,952.00 (\$190,428.00 less \$63,476.00), thus resulting in a total
47 wage and benefit expense of \$190,428.00.

1 **BY MR. WALKER: Please explain the error in Adjustment No. 12 – Rate Case**
2 **Expense.**

3
4 BY MR. WHITE: Adjustment 12 takes into consideration only the actual expense “to
5 date” of \$41,385.00. These expenses were only current through the beginning of
6 responding to the Office of Regulatory Staff’s data requests. This amount does not
7 include subsequent billings, the expense needed to complete the process, or for legal fees,
8 none of which are included in the “to-date” expenses. HPUC will provide the actual rate
9 case expense at the time of the hearings, as well as the revised estimate to complete the
10 process. The Office of Regulatory Staff’s use of \$41,385.00 understates the rate case
11 expense.

12
13 **BY MR. WALKER: Do you agree with Staff’s change to the amortization period of**
14 **the rate case expense?**

15
16 BY MR. WHITE: No, five years is too long a period between rate cases. The utility
17 will experience inflationary price increases to expense items, salary increases, and capital
18 investments for rehabilitation and replacement of existing plant facilities, all of which
19 will increase their cost of providing service and necessitate the filing of future rate cases,
20 generally at intervals of three to four years.

21
22 **BY MR. WALKER: Please describe the error in Adjustment No. 14 – Depreciation**
23 **Expense.**

24
25 BY MR. WHITE: The Office of Regulatory Staff disallowed depreciation expense on
26 assets that have reached their average service lives by system completion. Depreciation
27 of utility assets and service lives are developed as an averaging process. Some assets will
28 serve longer and some shorter than their average service lives, in either case, there will be
29 original or replaced depreciable assets in place to provide utility service to the customers,
30 the cost of which is recovered through depreciation expense. Theoretically, if the
31 original assets are retired precisely at the end of their service lives, the original assets
32 would be replaced. Therefore, the utility’s approach of including all assets in their
33 depreciation expense calculation at their original, not replacement cost, is conservative
34 for the complete system analysis. Staff’s removal of \$478,429.00 of the total
35 \$513,529.00 of Wastewater Treatment Plant costs from the depreciation expense
36 calculation is incorrect because it does not account for plant replacements, and does not
37 conform to utility group depreciation methodology which would apply depreciation until
38 the entire account is fully depreciated, not individual assets within the account.

39
40 **BY MR. WALKER: Please explain the problem with Adjustment No. 20 –**
41 **Accumulated Depreciation.**

42
43 BY MR. WHITE: Ms. Scott’s testimony states that “ORS and HPUC propose to adjust
44 accumulated depreciation based on the system utilization percentages”. Accordingly,
45 the only adjustment to accumulated depreciation should be for any accumulated
46 depreciation on plant asset additions made by the Office of Regulatory Staff. Staff has
47 added \$51,159.00 of plant additions, but increased the accumulated depreciation for the

1 complete system by \$171,427.00, an amount greater than the total of plant additions.
2 While Staff's calculation of accumulated depreciation has not been provided, its result is
3 not consistent with the fact that, if the plant additions were totally depreciated at the time
4 of system completion, the maximum adjustment to accumulated depreciation should not
5 exceed the original cost of those plant additions. Staff's adjustment to accumulated
6 depreciation appears to be incorrect and overstated.

7
8 **BY MR. WALKER: Please explain the problem with Adjustment No. 22 –**
9 **Contributions in Aid of Construction (CIAC) and Adjustment No. 23 –**
10 **Amortization of CIAC.**

11
12 BY MR. WHITE: The ORS Staff has erroneously applied HPUC's "availability charge"
13 or "availability fee" revenue as CIAC. Accordingly, Staff's adjustment to increase CIAC
14 by \$1,095,480.00 (\$547,740.00 water and \$547,740.00 sewer), the adjustment to increase
15 the accumulated Amortization of CIAC by \$171,360.00 (\$85,680.00 water and
16 \$85,680.00 sewer), and the adjustment reducing annual depreciation expense by
17 \$21,910.00 (\$10,955.00 water and \$10,955.00 sewer) should be rejected. Mr. John
18 Guastella will further address the availability charge or fee issues in his rebuttal

21 ~~BY MR. WALKER: Please explain the problem with Adjustment No. 24 –~~
22 **Capital.**

23
24 BY MR. WHITE: Staff's adjustment should calculate the working capital allowance
25 based on 1/5th of the complete system Operating and Maintenance Expenses (including
26 Administrative and General Expenses). Staff's adjustment, however, ignores the bad
27 debt expense impact (Adjustment No. 27) related to the revenue increase when
28 calculating their working capital allowance. Staff's adjustment is incorrect and
29 understated by \$2,187.00 (\$10,933.00 times 20%).

30
31 **BY MR. WALKER: Please describe the problem with Adjustment No. 25 –**
32 **Unamortized Balance.**

33
34 BY MR. WHITE: The Staff proposes to disallow the unamortized balance of rate case
35 expense from rate base, "resulting in a sharing of the expenses between the customer and
36 stockholder". The use of the complete system analysis assures a sharing of all expenses
37 during the growth period of the utility. The customers pay only their proportionate share
38 of complete system expenses and the income shortfalls are absorbed by the stockholders.
39 Staff's adjustment to disallow unamortized rate case expense places a disproportionate
40 share of the expense on the stockholders and should be rejected.

41
42 **BY MR. WALKER: Does this conclude your rebuttal testimony?**

43
44 BY MR. WHITE: Yes.

TAB C

DDE EIT ED DERITTAT

JOHN F. GUASTELLA

HAIG POINT UTILITY, INC.

DOCKET NO. 2005-34-W/S

**PRE-FILED REBUTTAL TESTIMONY OF JOHN F. GUASTELLA
BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

Testimony Prepared: July 7, 2005

Hearing Date: July 18, 2005

THIS TESTIMONY IS FILED PURSUANT TO PSC ORDER DATED APRIL

PURSUANT TO SAID ORDER AND TO THE PUBLIC SERVICE
COMMISSION'S RULES OF PRACTICE AND PROCEDURE, BY THE
COMMISSION STAFF AND INTERVENORS.

1 **BY MR. WALKER: Please state your name**

2

3 BY MR. GUASTELLA: John F. Guastella

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5 **BY MR. WALKER: Have you previously submitted prefiled direct testimony in this**
6 **proceeding?**

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8 BY MR. GUASTELLA: Yes.

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10 **BY MR. WALKER: Have you reviewed the prefiled testimonies and exhibits filed by the**
11 **Office of Regulatory Staff ("ORS"), Dr. Douglas Carlisle, Dawn M. Hipp and Sharon S.**
12 **Scott?**

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14 BY MR. GUASTELLA: Yes.

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16 **BY MR. WALKER: What is the purpose of your rebuttal testimony?**

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18 BY MR. GUASTELLA: My testimony addresses three issues: service availability revenues,
19 rate of return and rate case expenses.

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21 **BY MR. WALKER: What treatment does the ORS propose with respect to Availability**
22 **Fees and related revenues?**

23

26 rate base.

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28 **BY MR. WALKER: What reason do they give for such treatment?**

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30 BY MR. GUASTELLA: I was unable to find any reason for such treatment in their testimony.

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32 **BY MR. WALKER: Is such treatment proper?**

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34 BY MR. GUASTELLA: No.

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36 **BY MR. WALKER: Why not?**

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38 BY MR. GUASTELLA: HPUC charges lot owners who have not yet connected to the system an
39 annual service Availability Fee to cover a part of its annual operating and carrying costs of the
40 facilities it must have available in order to provide service to those customers when they do
41 connect in the future. The Availability Fees are not one-time "connection fees" or payments that
42 are typically used to fund a portion of the cost of the water or sewer systems. They are not,
43 therefore, Contributions in Aid of Construction ("CIAC"). The Availability Fees and revenues
44 also do not fit the descriptions of CIAC as contained in the Uniform System of Accounts. While
45 CIAC are deducted from rate base because they are customer supplied capital, HPUC's
46 availability revenues were not used to fund capital costs but instead to pay for operating and
47 carrying costs.

1 **BY MR. WALKER: Is this type of Service Availability Fee recognized in the industry as**
2 **not representing CIAC?**

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4 BY MR. GUASTELLA: Yes. The American Water Works Association ("AWWA") Manual,
5 M26, Water Rates and Charges, discusses Availability Charges and the circumstances under
6 which such charges are typically established.

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8 **BY MR. WALKER: I am going to hand you what I will mark as Applicant's Exhibit 7.**
9 **Can you identify it?**

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11 BY MR. GUASTELLA: Yes. This is the portion of the AWWA Manual, M26, I just discussed.

12 *[EXHIBIT 7]*

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15 **BY MR. WALKER: Can you describe what the manual discusses?**

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17 BY MR. GUASTELLA: Specifically, the AWWA Manual states that "the charge is normally
18 part of the utility's general water rate structure, made only between the time when service is first
19 made available and the time service actually goes into effect. Thereafter, the normal rate
20 structure takes over and the availability charge is terminated." The typical circumstances for the
21 charge is for "new water systems in which the immediate connected-customer base is small but
22 where a minimum level of revenue is necessary to make the installation of the water system
23 financially feasible." The AWWA Manual also considers the Availability Charge in contrast to
24 contributed capital, stating "Even in those situations where the utility has an effective program
25 for customer contribution of capital covering mains and other local facilities, the utility can incur
26 fixed costs and other costs for backup facilities." The manual gives an example of a new
27 development designed and built with the capacity to meet the needs of all potential customers.

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29 **BY MR. WALKER: How do HPUC's Availability Charge and connection fees compare**
30 **with the AWWA Manual?**

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32 BY MR. GUASTELLA: HPUC's Availability Charges and connection fees are precisely in line
33 with the proper rate setting principles and rate structure design described in the AWWA. HPUC
34 has charged one-time connection fees of \$500.00 each for water, sewer and irrigation service
35 and treat the amounts collected on the balance sheet as CIAC that are deducted from rate base,
36 because they were used to fund the cost of assets. HPUC's Availability Fees are annual charges
37 of \$90.00 each for water and wastewater service to cover a portion of the annual operating and
38 capital costs of having service available for "unconnected" customers, a fee that ceases when the
39 customer connects and is billed the general rates for service. The amounts collected from
40 Availability Fees are properly booked as revenues on the income statement, because they are
41 used to cover annual operating costs.

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43 **BY MR. WALKER: Do the revenues from Availability Fees affect the operating and**
44 **capital costs that would otherwise be absorbed by the stockholder or developer?**

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46 BY MR. GUASTELLA: Yes.

1 **BY MR. WALKER: Would that effect justify the treatment of those revenues as CIAC?**

2 BY MR. GUASTELLA: No. The availability revenues cover annual operating and carrying
3 costs, not the construction cost of the utility plant and facilities. I would note that many states
4 have established availability fees or "guaranteed revenue" charges (the same type of charge) and
5 do not treat the revenues as CIAC.

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7 **BY MR. WALKER: Do you have personal knowledge of the treatment of such charges in**
8 **other states?**

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10 BY MR. GUASTELLA: Yes.

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12 **BY MR. WALKER: Would you briefly describe some examples?**

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14 BY MR. GUASTELLA: Yes. I was involved in cases in Illinois that dealt with the Service
15 Availability Charges of Candlewick Lake Utilities, Inc. and Woodhaven Utilities, Inc. The
16 availability charges were found to be appropriate as a means of covering annual costs for
17 systems installed and having service available for lot owners that had not yet connected to the
18 system. The revenues were not treated as CIAC.

19
20 Guaranteed Revenue Charges are commonplace in many states as a means to have third party
21 developers or customers pay for the annual costs related to plant installed and reserved for future
22 customers. In addition to guaranteed revenue charges, the Florida Public Service Commission,
23 for example, has established a one time charge for newly connected customers, called an "AFPI"
24 charge (Allowance for Funds Prudently Invested) to cover the carrying costs related to the
25 portion of the plant that was considered to be "non-used and useful." The revenues collected are
26 treated as below the line income flowing directly to utility stockholders, and not treated as CIAC.

27
28 Another example is a rate case in which the Board of Public Utilities ("BPU") in New Jersey
29 approved a rate increase for Environmental Disposal Corp. ("EDC"). EDC's stockholder
30 developer had collected about \$8 million of "capacity" fees from neighboring municipalities that
31 would use EDC's excess capacity under a bulk service agreement. The one time capacity charge

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33 capacity payments to EDC's stockholders as CIAC for rate setting purposes. On appeal, the
34 Appellate Division of the Superior Court of New Jersey, A-0286-00T3, April 3, 2002, affirmed
35 the BPU's decision that the capacity payments to EDC's stockholders were reimbursements for
36 carrying costs and should not be treated as CIAC.

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39 **BY MR. WALKER: Will HPUC's stockholder still absorb significant amounts of carrying**
40 **costs under the complete system rate analysis, despite the collection of annual revenues**
41 **through Availability Fees?**

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43 BY MR. GUASTELLA: Yes. At my direction, Mr. White has prepared a schedule for water
44 and sewer operations projecting the operating deficits with and without availability revenues for
45 each year from 2005 through 2014, under proposed rates. These schedules show that HPUC's
46 stockholder will absorb a significant amount of HPUC's carrying costs during the growth years,
47 even though the availability revenues will absorb a portion of such costs.

1 **BY MR. WALKER: Are the schedules that I have marked as Applicant's Exhibit 8 the**
2 **schedules prepared by Mr. White which you have just described?**

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4 BY MR. GUASTELLA: Yes.

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6 **BY MR. WALKER: Were the Schedules contained in Applicant's Exhibit 8 prepared**
7 **under your direction and supervision?**

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9 BY MR. GUASTELLA: Yes.

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11 **BY MR. WALKER: Do you agree with the existing rate of return of 9.65% recommended**
12 **by Dr. Carlisle?**

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14 BY MR. GUASTELLA: No. Dr. Carlisle's analysis is based on a proxy group of much larger
15 utilities using current financial data at a time when capital cost rates are relatively low. He does
16 not make any projection for a complete system when more average conditions may be more
17 appropriate. Dr. Carlisle also does not make any adjustment for the size of HPUC in relation to
18 the water utilities in his proxy group. Using the ORS adjustments, including Dr. Carlisle's
19 recommended rate of return on equity, the resulting operating margin would only be 11.5%.
20 That level of operating margin is less than those of the comparisons I show on Schedule A-1 of
21 Applicant's Exhibit 4 for all but the largest water utilities with revenues from \$5-\$10 million.
22 Accordingly, Dr. Carlisle does not adequately allow for the sensitivity to earnings erosion that is
23 greater for small utilities. He also does not give adequate consideration to the ability of small
24 utilities to attract capital or compete for funds with large utilities. For example, given the same
25 allowed rate of return on equity, it is inconceivable that an investor would buy the stock of
26 HPUC instead of the stock of one of the larger water utilities.

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28 **BY MR. WALKER: Is there any other factor affecting the rate of return of HPUC?**

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30 BY MR. GUASTELLA: Yes. ORS has recommended that the average unamortized balance of
31 rate case expenses be excluded from rate base. Failure to allow for the carrying costs related to
32 rate case expenses will require the stockholder to absorb those costs. Thus, the ORS's
33 recommended rate of return is not the actual rate of return that its adjustments, in their totality,
34 would allow. In my opinion, the rate of return recommended by the ORS and resulting
35 operating margin are inadequate, and the recommendation to disallow the average unamortized
36 balance of rate case expenses in rate base should be rejected. Mr. White discusses other issues
37 with respect to rate case expenses.

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39 **BY MR. WALKER: Does that complete your rebuttal testimony?**

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41 BY MR. GUASTELLA: Yes.